

ANALYSIS OF AMENDED BILL

Author: La Malfa Analyst: Nicole Kwon Bill Number: AB 2953
Related Bills: See Legislative History Telephone: 845-7800 Amended Date: April 6, 2006
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/Any Loss Sustained As A Result Of A Disaster That Occurs On Or After January 1, 2007

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of any disaster that occurs on or after January 1, 2007.

SUMMARY OF AMENDMENTS

The April 6, 2006, amendments struck the previous provisions relating to relief procedures in the event of a disaster or other emergency and replaced them with the provisions providing special tax treatment for losses as a result of any disaster that occurs on or after January 1, 2007.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to provide immediate tax relief to individuals and businesses affected by a disaster in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment, and operative for disasters occurring on or after January 1, 2007.

POSITION

Pending.

ANALYSIS**FEDERAL/STATE LAW**

Under federal and state law, a disaster loss occurs when property is destroyed as a result of a fire, storm, flood, or other natural event in an area proclaimed to be a disaster by the President of the United States or, for state law purposes, by the Governor.

Board Position:

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_____ N	_____ OUA	_____ X PENDING

Department Director

S. Stanislaus

Date

5/4/06

Under federal and state tax law, the taxpayer may elect to claim the loss either in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to file an amended return immediately for the prior year. For state purposes, this election may be made for any Presidentially-declared disaster prior to passage of any state legislation allowing special carryover treatment because California conforms to federal law in this area without the need for additional state enabling legislation. The election is available for a Governor-only declared disaster only if enabling legislation is enacted.

The loss for tax purposes is calculated as the lesser of the reduction in fair market value (FMV) or the adjusted basis. This value is reduced by insurance or other reimbursements. A nonbusiness disaster loss not reimbursed by insurance or otherwise is further deductible under both state and federal tax law to the extent of two limitations: basis limitation and adjusted gross income (AGI) limitation. Under the basis limitation, a nonbusiness disaster loss is deductible to the extent the loss exceeds \$100. Under the AGI limitation, total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of AGI.

State tax law identifies specific events as disasters that are then allowed additional special loss carry over treatment. Carryover of a disaster loss occurs when the loss computed exceeds the taxable income. Under special loss carryover treatment, 100% of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, the remaining loss may be carried over at 100% for up to 10 additional years.

THIS BILL

This bill would add any disaster or any related casualty that is declared by the President¹ and any Gubernatorial declaration of a disaster² that occurs on or after January 1, 2007, to the current list of specified disasters under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).

Specifically, this bill would allow special disaster loss carry forward treatment of losses sustained as a result of any disaster. For business property, the lesser of the reduction in FMV or the adjusted basis would apply to disaster losses. The \$100 and 10% of AGI limitations in existing law would apply to disaster losses on nonbusiness property.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

AB 912 (Ridley-Thomas, 2005/2006) would allow a credit to taxpayers who provide housing to individuals displaced by a federally declared disaster. AB 912 is currently in the Assembly Revenue and Taxation Committee.

¹ Internal Revenue Code section 165 (i).

² Revenue and Taxation Code sections 17207 (d) and 24347.5 (d)

AB 1798 (Berg, 2005/2006) and AB 2735 (Nava, 2005/2006) would allow taxpayers disaster loss treatment for losses sustained as a result of the severe rainstorms and related events that occurred in the specified counties in December 2005 or January 2006. Both AB 1798 and AB 2735 are currently in the Assembly Revenue and Taxation Committee.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 2953 Effective for Tax Years BOA 1/1/2007 Assumed Immediate Enactment				
(Millions)				
2006/2007	2007/2008	2008/2009	2009/2010	2010/2011
No impact	-\$1	-\$11	-\$18	-\$24

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The revenue impact of this bill is dependent upon the number of state disasters declared in any year, as well as the portion of individual losses not covered by insurance.

The number and severity of disasters that will be declared in any year is unknown. This estimate is based on the average value of private losses over a 30-year period. In any given year, losses generated could fluctuate and could be substantially lower or higher than the average used in this estimate.

Based on an analysis of all California disasters from 1968-1998 and adjusting for the effect of inflation, it is estimated that average damages from disasters would be approximately \$2 billion per year.

For tax year 2007, it is estimated that 15% or \$300 million of these losses would not be insured. Because some insurance policies cover a fixed amount of damages rather than FMV, it is estimated that of the insured portion (85% x \$2 billion = \$1.7 billion) 30% would not be reimbursed by an insurance policy. Combined uninsured losses would be \$810 million [\$300 million + (\$1.7 billion x 30%)].

These uninsured losses are reduced by \$24 million to account for basis and AGI limitations, resulting in \$786 million (\$810 million - \$24 million) in possible deductions. It is estimated that 35%

or \$275 million in deductions would be used during the year of the event and 5% or \$39 million would never be reported and therefore would not impact this bill.

Assuming an average marginal tax rate of 6% on the remaining \$472 million (\$786 million - \$275 million - \$39 million), this bill's revenue loss would total \$28 million (\$472 million X 6%). The cash flow revenue loss would total \$1 million beginning in fiscal year 2007/2008 through altered estimated payments and increase to \$10 million for fiscal year 2008/2009. The revenue impact for fiscal year 2009/2010 would include carryover losses generated in 2007 plus new losses generated in 2008.

LEGISLATIVE STAFF CONTACT

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